Asian overview

Monthly commentary

November 2014

Overview

Asia's regional benchmark rebounded in October, with monetary policy the dominant theme. While the US Federal Reserve turned off the tap on quantitative easing, the European Central Bank embarked on a new stimulus programme of bond purchases to support growth. This lifted market sentiment initially weighed down by poor economic data and the International Monetary Fund's growth forecast downgrades. With share prices balanced on a knife's edge, the Bank of Japan provided a late dose of confidence, with its proposal to expand the monetary base to ¥80 trillion a year to stave off deflation. This tipped the benchmark into positive territory.

Among the biggest gainers were China, Hong Kong and Australia, which were key laggards in the previous month. The pro-democracy movement in Hong Kong remained on the streets at the time of writing as talks between the government and student leaders fizzled. China held its fourth plenary session that focused on legal reforms. Third-quarter GDP expansion slowed, but exceeded expectations. Australia rebounded along with China. India finished at record highs as sentiment was buoyed by the ruling Bharatiya Janata party's victories in two significant state elections, which consolidated its power and added to the reform momentum. In response to the Supreme Court's cancellation of coal-mining licences, the private sector was granted approval to participate in the re-auction of coal blocks, which they could eventually mine commercially. Auction proceeds would go to the states where the mines are located, which should encourage local government support. Conversely, laggards included Korea, Singapore and Japan, which continued to grapple with global growth concerns. The BOJ's increased stimulus, along with the plan to expand the allocation of both domestic and foreign equity assets in Japan's Government Pension Investment Fund, lifted confidence, but failed to prevent the local market from underperforming the region.

The divergence between major central banks' monetary policies has become more pronounced, although how that translates into global capital flows is uncertain. In Asia, the slowdown in China remains a key concern and should continue to sway market sentiment. Weaker mainland demand has hurt major trading partners, and economic activity could slow further with Beijing trying to prevent runaway credit expansion. Ultimately, that should improve the quality of growth, even if it takes longer to achieve. Meanwhile, falling global oil prices has brought some reprieve to oil importing nations. In particular, India and Indonesia now have greater room to revise subsidies. This should help fix fiscal imbalances that until recently have handcuffed government spending on crucial areas such as infrastructure. India did just that, hiking gas prices while eliminating diesel subsidies. Indonesia, under newly appointed president Joko Widodo, has made tackling fuel subsidies a cornerstone of its economic rejuvenation plan, although implementation might face opposition. Japan too should benefit as lower oil prices mitigate the impact of the weaker yen on energy imports.

Corporate news

Australia: Blood products maker **CSL** will buy back A$950 million-worth of its shares. With this purchase, it will have returned around 23% of its shares in cash since 2005. Separately, we think the company's purchase of Swiss drugmaker Novartis's flu vaccine business is an opportunistic deal that has great potential. The US$275 million acquisition will be funded with surplus cash.

China/Hong Kong: **Standard Chartered**'s shares weakened after the third profit warning in a year as the bank delivered its nine-month results. It blamed high impairment charges as some corporate and institutional clients were hurt by weakening commodity markets. Sentiment was also depressed by speculation that US regulators could re-investigate its alleged sanction violations. Some of its problems are cyclical and should be resolved in the medium term. More structural ones will require management to reprioritise investments, divest non-core businesses and streamline riskier portfolios. StanChart's advantage is its peerless focus on emerging markets, replete with banking licences and long-term customer relationships, something that cannot be easily replicated. It is an exciting franchise, though we would not be surprised by a management change.

Lower oil prices hurt **PetroChina** and **CNOOC**'s profitability. However, higher gas prices kept PetroChina's profit slide in check. CNOOC's production was flat and although the company expects a significant pipeline of projects to be added in 2015, we remain circumspect.

Elsewhere, we remained engaged with multi-brand fast-food chain operator **Yum! Brands** after it reported sluggish results on the back of the industry-wide food safety scandal in China. We continue to believe in management's ability to steer the company through this tough period, supported by its solid fundamentals. As expected, **China Mobile**'s results were weighed down by the value-added tax and increased tariff subsidies. Encouragingly, 4G subscriber growth and data revenues continued to pick up. **ASM Pacific**'s earnings were boosted by its solid order book. A healthy backlog should drive its momentum into the fourth quarter. Insurer **AIA Group** reported solid new business growth in all of its key markets except Korea.

India: Our bank holdings reported largely positive results. **Housing Development Finance Corp** was lifted by robust loan growth, higher margins and stable asset quality. Similarly, **ICICI Bank**'s margins were healthy, while retail loans in its mortgage and auto divisions grew rapidly. However, it faced some pressure from subdued corporate loans and higher credit costs. In the IT sector, **Infosys** reported better-than-anticipated margins on improved sales and higher employee utilisation. Conversely, **Tata Consultancy Services**'s earnings missed expectations, which could make achieving its full-year growth target a challenge. Meanwhile, TCS will merge with its majority-owned subsidiary **CMC**. Elsewhere, **Hero MotoCorp** enjoyed solid sales growth amid signs it is winning back market share, while **UltraTech Cement** benefited from recovering domestic demand. However, its share price faltered on speculation it was interested in assets sold off as part of the Holcim-Lafarge merger.

Indonesia: **Unilever Indonesia** posted robust revenues, but earnings were hurt by increased operating expenses and advertising costs. We think margins could remain under pressure going into the first half of 2015 particularly if the government succeeds in removing fuel subsidies, which could elevate costs further in turn.

Japan: Most of our holdings' quarterly results met our expectations. Among the exceptions was **Honda Motor**, which lowered its full-year sales target in China and Japan as recalls were expected to delay new model launches. Retail holding **Seven & i** posted good results but management was cautious in its outlook for household demand on the back of the sales tax hike. **Canon**'s results were mixed and it continued to suffer from sluggish demand. However, the company upgraded its full-year profit outlook, thanks to ongoing cost cuts and the weak yen. Canon subsequently announced its third share buyback this year, which we are positive about. **Japan Tobacco** raised its full-year forecast to reflect yen weakness and overseas growth.

Malaysia: The government's goal of creating an Islamic bank to compete globally faced a setback as the stock exchange **Bursa Malaysia** ruled that state pension fund EPF would not be allowed to vote in the merger of lenders **CIMB Group**, RHB Capital and Malaysia Building Society. EPF holds large stakes in all three and thus would breach rules designed to protect minority shareholders. EPF has appealed against the ruling. We think the deal may go through since other big investors appear to back the government's stance.

Key measures in the government's 2015 budget included cuts to corporate and personal income taxes, as well as hand-outs for the poor. Implementation of the good-and-services tax remained on track, but more goods, including petrol and newspaper, were exempted. This is positive for our holding **Star Publications**.

Alcohol and tobacco excise duties were left unchanged, which could benefit **Carlsberg Brewery Malaysia**, **Guinness Anchor** and **British American Tobacco Malaysia**.

Singapore: Both **Keppel Corp** and **SembCorp Marine**'s share prices took a hit on fears that oil prices would slide further and hurt their ability to win new orders. That said, Keppel Corp's offshore and marine segment posted resilient earnings backed by a robust order book, which offset weaker performance in the property division given ongoing cooling measures. Both companies continued to secure new orders.

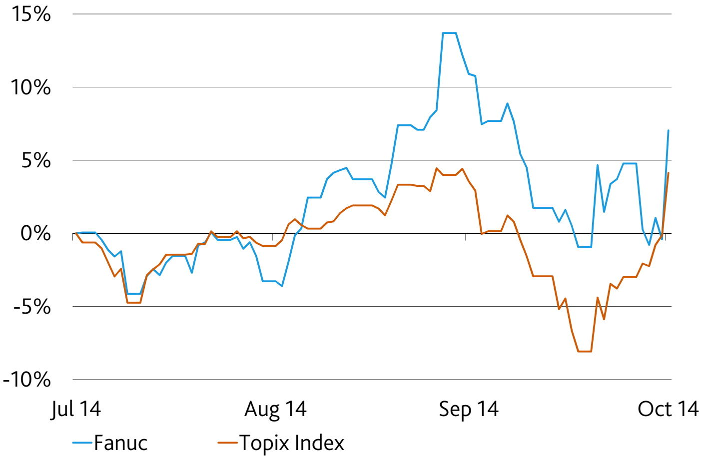
Our bank holdings reported decent results, even though the slowdown in the region led to a moderation in loan growth and uptick in non-performing loans. That said, overall asset quality is still healthy. **DBS Group**'s efforts in wealth management and global transaction services boosted non-interest income and also registered the highest net interest margin improvement among its peers. **Oversea-Chinese Banking Corp**'s bottom-line was bolstered by its increased stake in Bank of Ningbo, in addition to contributions from the Wing Hang Bank acquisition. However, profits from its life assurance business declined. **United Overseas Bank**'s results were the least stellar, with earnings driven mainly by higher trading and investment income. It suffered from non-performing loan issues at a local high-end residential project, and also in Indonesia. Nevertheless, it remains the best-capitalised of the three.

Taiwan: We are positive about **Taiwan Mobile**'s acquisition of a block of 4G spectrum from competitor Ambit Microsystems, while also taking a 14.9% stake in the company. We believe the purchases will help enhance Taiwan Mobile's network quality and bolster its competitive edge.

Thailand: The government's plan to offer new licences for oil and gas exploration should aid **PTT Exploration & Production**, the country's sole operator in the sector. The company reported higher third-quarter sales, but net profits declined because of write-offs in a number of projects.

We hold the companies highlighted.

Focus: Fanuc – Rise of the machines



Source: Bloomberg, 5 November 2014

Our holding Fanuc reported record sales and operating profits in the second quarter, helped by robust demand for its RoboDrills, used in the production of smartphones. This has kept the company's factories running at full capacity. The outlook is bright. While Apple has been its key client for RoboDrills, metal casings could become the de facto standard for Android smartphones too, which bodes well for Fanuc. The company's production outstrips most of its competitors and should place it in an ideal position to capitalise on this trend. Meanwhile, its mainstay factory automation business is also expected to keep growing. Asian companies particularly those in China – the world's largest buyer of industrial robots – will continue to automate their operations to mitigate the impact of rising labour costs.

Performance of Asia Pacific stockmarkets

	31/10/2014	1 month (%)			Year to date (%)		
	Local currency	Local currency	US$	£	Local currency	US$	£
Msci Ac Asia Pacific	127.34	1.96	1.09	2.44	3.30	0.35	3.89
Australia Asx All Ordinaries	5505.00	3.93	4.40	5.79	2.84	1.04	4.60
China Shanghai Se B Share	262.04	-2.28	-2.28	-0.98	3.32	3.32	6.96
Hong Kong Hang Seng	23998.06	4.64	4.78	6.17	2.97	2.95	6.58
India Bse S&P Sensex(Bse30)	27865.83	4.64	5.25	6.65	31.62	32.60	37.27
Indonesia Jsx Composite	5089.55	-0.93	-0.12	1.21	19.08	19.91	24.14
Japan Topix	1333.64	0.55	-1.61	-0.30	2.41	-3.99	-0.60

	31/10/2014	1 month (%)			Year to date (%)		
	Local currency	Local currency	US$	£	Local currency	US$	£
Korea Kospi Composite	1964.43	-2.76	-3.98	-2.70	-2.33	-3.56	-0.16
Malaysia Klse Composite	1855.15	0.48	0.21	1.55	-0.63	-1.05	2.44
New Zealand Nzx All(Cap)	1088.78	2.23	2.02	3.38	9.00	3.02	6.65
Pakistan Kse 100	30376.53	2.19	1.99	3.35	20.25	23.08	27.41
Philippines Psei	7215.73	-0.92	-0.92	0.40	22.51	21.17	25.44
Sri Lanka Cse All Share	7326.81	1.03	0.76	2.10	23.91	23.94	28.31
Taiwan Taiex	8974.76	0.09	0.10	1.43	4.22	2.12	5.72
Thailand Set	1584.16	-0.10	-0.54	0.78	21.98	23.07	27.40
MSCI India	1035.03	3.21	3.81	5.20	26.66	27.60	32.10
MSCI Singapore Free	368.31	-0.50	-1.29	0.03	0.97	-0.83	2.66

Source: Factset, 31 October 2014

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